No. 93-695

IN THE
# Supreme Court of the United States
OCTOBER TERM, 1993

OFFICIAL COMMITTEE OF UNSECURED CREDITORS OF COLUMBIA GAS TRANSMISSION CORPORATION,
*Petitioner,*

v.

COLUMBIA GAS TRANSMISSION CORPORATION, *et al.*,
*Respondents.*

**On Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit**

## BRIEF IN OPPOSITION FOR RESPONDENT OFFICIAL COMMITTEE OF CUSTOMERS OF COLUMBIA GAS TRANSMISSION CORPORATION


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## QUESTION PRESENTED

Whether, in construing the Bankruptcy Code, the court of appeals applied the appropriate test in deciding that federal common law rather than state law should govern.

## LIST OF PARTIES AND RULE 29.1 LIST

The caption of the decision below (Pet. App. 1a-37a)* contains the names of the parties.

The Official Committee of Customers of Columbia Gas Transmission Corporation is the official body appointed by the United States Trustee pursuant to Section 1102 of the Bankruptcy Code, 11 U.S.C. § 1102, to represent the interests of the customers of Columbia Gas Transmission Corporation. The publicly held customers on whose behalf the Committee acts are:

Baltimore Gas and Electric Company
Central Hudson Gas & Electric Corp.
Columbia Gas Distribution Co.
Commonwealth Gas Services, Inc.
Corning Natural Gas Corp.
Delmarva Power and Light Co.
Delta Natural Gas Company, Inc.
Eastern Short Natural Gas Company, Inc.
Elizabethtown Gas Company, Inc.
Kentucky Ohio Gas
Lakeside Gas
Mountaineer Gas Company
National Fuel Gas Supply Corp.
National Gas & Oil, Inc.
New Jersey Natural Gas Company
New York State Electric & Gas Corp.
North Carolina Natural Gas Corp.
Northeast Ohio Gas
Orange and Rockland Utilities, Inc.
Pennslyvania Gas & Water Company
Peoples Natural Gas Co.
Piedmont Natural Gas Company, Inc.
Roanoke Gas Company, Inc.
South Jersey Gas Company
The Cincinnati Gas & Electric Company

* "Pet. App." citations are to the appendix to the petition.

The Dayton Power and Light Company
The Providence Gas Company
The Union Light, Heat & Power Company
UGI Corp.
Verona Natural Gas
Virginia Natural Gas Corp.
Washington Gas Light Company
West Ohio Gas Company, Inc.

TABLE OF CONTENTS


| | Page |
|---|---|
| QUESTION PRESENTED | i |
| LIST OF PARTIES AND RULE 29.1 LIST | ii |
| TABLE OF AUTHORITIES | vi |
| OPINIONS BELOW | 1 |
| JURISDICTION | 1 |
| STATUTES INVOLVED | 2 |
| STATEMENT OF THE CASE | 2 |
| 1. Background | 2 |
| 2. The Refunds At Issue Here | 3 |
| 3. The Proceedings Below | 4 |
| REASONS FOR DENYING THE WRIT | 6 |
| I. THE PETITION MISCHARACTERIZES THE DECISION BELOW | 6 |
| II. THERE IS NO CONFLICT AMONG THE CIRCUITS | 9 |
| III. THE RESULT BELOW WAS CORRECT | 11 |
| CONCLUSION | 14 |

## TABLE OF AUTHORITIES

*CASES* Page

*Associated Gas Distribs. v. FERC*, 893 F.2d 349 (D.C. Cir. 1989), *cert. denied*, 498 U.S. 907 (1990) ..... 3
*Burks v. Lasker*, 441 U.S. 471 (1979) ..... 7, 8
*Butner v. United States*, 440 U.S. 48 (1979) ..... 7, 13
*Columbia Gas Trans. Corp. v. Exclusive Natural Gas Storage Easement*, 962 F.2d 1192 (6th Cir.) *cert. denied*, 113 S. Ct. 659 (1992) ..... 8
*In re Iowa R.R.*, 840 F.2d 535 (7th Cir.), *cert. denied*, 488 U.S. 899 (1988) ..... 9
*In re Penn Central Transportation Co.*, 486 F.2d 519 (3rd Cir. 1973) ..... 10
*Kamen v. Kemper Financial Services, Inc.*, 111 S. Ct. 1711 (1991) ..... 6, 7
*Lewis v. Manufacturers National Bank of Detroit*, 364 U.S. 603 (1961) ..... 13
*Missouri Pac. R.R. Co. v. Escanaba & Lake Superior R.R.*, 897 F.2d 210 (6th Cir. 1990) ..... 10
*T&B Scottsdale Contractors, Inc. v. United States*, 866 F.2d 1372 (11th Cir.), *cert. denied*, 493 U.S. 846 (1989) ..... 13
*United Gas Pipe Line Co. v. Memphis Light, Gas & Water Div.*, 358 U.S. 103 (1959) ..... 3
*United States v. Kimbell Foods*, 440 U.S. 715 (1979) ..... 4
*United States v. Little Lake Misere Land Co., Inc.*, 412 U.S. 580 (1973) ..... 7
*United States v. Standard Oil Co. of Calif.*, 332 U.S. 301 (1947) ..... 7

*STATUTES*

Bankruptcy Reform Act of 1978, As Amended (1993)
11 U.S.C. § 541(d) ..... 4, 5, 6, 7, 8
Natural Gas Act (1988 & Supp. III 1991)
15 U.S.C. §§ 717c ..... 2
15 U.S.C. §§ 717-717(W) ..... 2

*REGULATIONS*

11 C.F.R. pt. 201 (1993) ..... 3

TABLE OF AUTHORITIES—Continued

*OTHER* Page

Mishkin, *The Variousness of "Federal Law": Competence and Discretion in the Choice of National and State Rules for Decision*, 105 U. Pa. L. Rev. 797 (1957) ..... 7

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## BRIEF IN OPPOSITION FOR RESPONDENT OFFICIAL COMMITTEE OF CUSTOMERS OF COLUMBIA GAS TRANSMISSION CORPORATION

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### OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-74a) is reported at 997 F.2d 1039. The opinion of the district court (Pet. App. 75a-122a) is not reported. The opinion of the bankruptcy court (Pet. App. 123a-144a) is reported at 136 B.R. 930.

### JURISDICTION

The judgment of the court of appeals was entered on July 6, 1993. The order of the court of appeals denying the Creditor Committee's petition for rehearing was entered on August 6, 1993. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

## STATUTES INVOLVED

The statutes involved appear in the petition. (Pet. 2).

## STATEMENT OF THE CASE

1. *Background.* This case arises out of the bankruptcy of Columbia Gas Transmission Corporation ("Columbia"), the owner and operator of a large natural gas pipeline. Columbia purchases natural gas from upstream pipeline suppliers, transports the gas in interstate commerce, and resells it to local distribution companies who in turn sell it to the gas-consuming public.

Both Columbia and its upstream pipeline suppliers are extensively regulated by the Federal Energy Regulatory Commission ("FERC") pursuant to the Natural Gas Act ("NGA"), 15 U.S.C. §§ 717-717(W) (1988 & Supp. III 1991). Under the NGA, a regulated entity may charge only "just and reasonable" rates. 15 U.S.C. § 717c. FERC normally exercises its ratemaking authority by allowing proposed rate increases to go into effect subject to its power to order refunds if it determines, after a hearing, that the new rate is not just and reasonable.

Part of Columbia's rate to each of its customers is determined, under applicable FERC orders and tariffs, by certain charges made by Columbia's upstream suppliers and then passed on by Columbia, acting as a conduit, to its customers. When, in the exercise of its ratemaking authority, FERC orders Columbia's upstream suppliers to make refunds, those refunds are flowed through Columbia dollar-for-dollar to Columbia's customers, and, ultimately, to the gas-consuming public.[1] Columbia's obligation to flow through such refunds is imposed by law and cannot be altered by private agreement between Columbia and its

[1] Some of Columbia's customers are affiliated with Columbia, but those customers themselves must flow through any refunds received to the ultimate consumers. (Pet. App. 59a-60a). Thus, neither Columbia nor its affiliates stand to gain from flowing through the refunds.

suppliers or customers. This is because "FERC's ability to regulate gas rates is not in any way limited by the existence of private contracts since all contracts are 'subject of course to any overriding authority of the Commission.' " (*Id.*, quoting *United Gas Pipe Line Co. v. Memphis Light, Gas & Water Div.*, 358 U.S. 103, 114 (1959)).[2]

2. *The Refunds At Issue Here.* In 1988, various upstream suppliers of Columbia made filings pursuant to FERC Order 500, which permitted them to recover a portion of the costs they incurred in buying out or buying down certain so-called "take-or-pay" contracts with gas producers. (Pet. App. 127a). Under Order 500, Columbia's suppliers had collected, through Columbia, approximately $250 million from Columbia's customers, who had collected that amount from the gas-consuming public, when the D.C. Circuit held that the allocation methodology used by FERC to allocate the "take or pay" costs among customers was unlawful, and vacated Order 500. *Associated Gas Distribs. v. FERC,* 893 F.2d 349, 362-63 (D.C. Cir. 1989), *cert. denied,* 498 U.S. 907 (1990). FERC subsequently issued Order 528, requiring the pipelines that had made Order 500 tariff filings to file revised tariffs using lawful allocation methods and to refund the unlawful overcharges collected under Order 500.

The "take or pay" refunds constitute about $134 million of the $161 million at issue here. The remaining refunds consist of other overcharges for gas transportation services. (Pet. App. 43a). All of the disputed refunds

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[2] Federal law also dictates how Columbia accounts for the customer refunds. FERC regulations set forth a detailed uniform system of accounts which natural gas companies like Columbia must follow. *See* 18 C.F.R. pt. 201 (1993). The regulations dictate the manner in which accounting records must be kept and reported. (Pet. App. 128a-129a). Columbia's accounts thus track all customer refunds by period, legal type, upstream sources, and downstream recipient. (*Id.*)

were ordered by FERC to be paid by Columbia's upstream suppliers and to flow through Columbia to its customers and, ultimately, to the consumers. (*Id.* at 59a-60a).

3. *The Proceedings Below.* Columbia itself has no interest in these refunds. Its role is to receive them from its upstream suppliers and pass them down to its customers in accordance with applicable FERC orders and tariffs. (Pet. App. 59a-60a & n.11). Accordingly, shortly after filing for bankruptcy, Columbia moved for authorization to comply with FERC orders and its own tariff and to flow through to its customers the refunds that it had received or would receive in the future. Columbia took the position that it held no equitable interest in the refunds and that, accordingly, the refunds were not property of the debtor under § 541(d) of the Bankruptcy Code. Columbia's unsecured creditors opposed the motion, contending that the refunds should be treated as Columbia's property and made available to pay their claims.

The bankruptcy court granted Columbia's motion, applying federal common law and ruling that the customer refunds are not property of Columbia's estate but are held in trust for the benefit of Columbia's customers. (*Id.* at 134a-136a). The district court reversed, concluding that state law should apply and that under state law the customer refunds should be considered property of Columbia's estate. (*Id.* at 101a-104a).

The court of appeals in turn reversed the district court. It applied the three factors identified in *United States v. Kimbell Foods,* 440 U.S. 715 (1979), and ruled that federal common law should govern because, among other reasons addressed more fully below, application of state law would frustrate the central purpose of the NGA of assuring just and reasonable rates. The Third Circuit then held, in light of the factual findings made by the bankruptcy court, that the customer refunds were held in trust by Columbia and were, therefore, excluded from

Columbia's estate under § 541(d). (Pet. App. 55a-63a). On a secondary issue, the court applied the lowest intermediate balance test, a common law trust doctrine, to restrict the amount of prepetition customer refunds that could be flowed through to Columbia's customers.

In a separate opinion, Judge Nygaard concurred with the majority that Columbia's interest in the refunds should be decided as a matter of federal common law rather than state law, and that (although here his reasoning differed from the majority's) the customer refunds were not property of Columbia's estate. He dissented, however, from the majority's application of the lowest intermediate balance test. (Pet. App. 69a-74a).

FERC participated as an *amicus curiae* in the court of appeals. It argued that the application of federal common law was required to promote uniformity and to ensure that state law did not interfere with the overriding federal objective of just and reasonable rates under the NGA. Brief of Amicus Curiae Federal Energy Regulatory Commission, at 19-28, in *In re The Columbia Gas System, Inc. and Columbia Gas Transmission Corporation,* 3rd Cir., Nos. 92-7395 *et al.,* filed Oct. 2, 1992. FERC also noted that "[i]t was clearly not the intent of the Commission that Columbia have any equitable interest in the refunds it held temporarily before they were flowed through to its customers." *Id.* at 29.

## REASONS FOR DENYING THE WRIT

This case involves only the application of settled law to particular facts. It presents no conflict among the circuits and raises no issue of general importance warranting review by this Court. The petition's contrary depiction of the decision below—as a sweeping, conflict-creating repudiation of this Court's teachings—relies on a fundamental mischaracterization of the Third Circuit's opinion, as we now show.

### I. THE PETITION MISCHARACTERIZES THE DECISION BELOW.

The petition repeatedly misdescribes the breadth of the court of appeals ruling in this case—as, for example, when it says that "in the Third Circuit federal law now will *always* preempt state law" "with respect to claims against a federally regulated bankrupt" (Pet. 14; emphasis in original). That and other similar statements in the petition are demonstrably incorrect.

The Third Circuit began its analysis with the truism that the construction of a federal statute is a matter of federal law, citing *Kamen v. Kemper Financial Services Inc.*, 111 S. Ct. 1711, 1717 (1991). (Pet. App. 47a). "Therefore," the court continued, "federal law defines the parameters of section 541(d) of the Bankruptcy Code." (*Id.*) That incontestable statement, however, did not resolve the central question in this case, namely whether the issue under § 541(d) should be resolved by applying state law or by applying a uniform federal common law rule. The Third Circuit made that clear with its next words:

> This, however, is only the beginning of the inquiry. The determination that federal law applies does not inevitably require the application of a uniform federal rule. Applying federal law, courts may either fashion a uniform federal common law rule or adopt state law as the federal rule of decision.

(*Id.*) Far from stating that federal common law should always or normally displace state law as the rule of decision, the court explicitly stated the contrary:

> Developing a federal common law rule is the exception rather than the rule. Federal law should coincide with the relevant state law unless state law would undermine the objectives of the federal statutory scheme and there is a distinct need for nationwide legal standards.

(Pet. App. 48a). The court then carefully applied the factors set forth in this Court's decision in *Kimbell Foods* to determine whether a uniform federal standard was required. (*Id.* at 48a-55a).

The Third Circuit's initial observation was nothing more than a recognition that federal courts have the *power* to declare federal common law " 'to fill in interstitially or otherwise effectuate the statutory patterns enacted in the large by Congress.' " *United States v. Little Lake Misere Land Co., Inc.*, 412 U.S. 580, 593 (1973) (quoting Mishkin, *The Variousness of "Federal Law": Competence and Discretion in the Choice of National and State Rules for Decision*, 105 U. Pa. L. Rev. 797, 800 (1957)). The existence of such federal judicial power, however, means only that state law does not apply "of its own force"; state law will still presumptively be adopted as the federal rule of decision unless federal interests require the application of a uniform federal standard. *See, e.g., Kamen*, 111 S. Ct. at 1717; *Burks v. Lasker*, 441 U.S. 471, 476-77 (1979); *Little Lake Misere*, 412 U.S. at 593-94; *United States v. Standard Oil Co. of California*, 332 U.S. 301, 307-09 (1947).[3]

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[3] The Creditor Committee does not argue that state law applies of its own force under § 541(d) of the Bankruptcy Code. The Creditor Committee acknowledges that under this Court's decision in *Butner v. United States*, 440 U.S. 48, 55 (1979), property rights under the Bankruptcy Code will generally be determined under state

The petition, however, suggests that the Third Circuit's introductory observation that federal statutory construction is a matter of federal law was not merely a threshold comment, but instead a holding on the central issue in the case—*i.e.*, a holding that *all* property determinations under § 541(d) are necessarily governed by federal common law rather than state law.[4] Only by so mischaracterizing the court's preliminary remark can the petition make the plainly incorrect statements, in addition to the one mentioned above, that: "in the Third Circuit, the federal common law exception has now completely swallowed the state law rule—the decision below holds that federal law governs *all* trust determinations under § 541(d) of the Bankruptcy Code" (Pet. 8-9) (emphasis in original); that "in the Third Circuit the mere existence of federal regulation suffices to preempt state trust and property law" (*id.* 12); and that the court below "greatly expanded the role of federal common law to *all* trust determinations pursuant to § 541(d)." (*Id.* 13) (emphasis in original).

Each of those statements is unsupportable. A fair reading of the ruling below shows that it was tied closely to the particular facts of this case, that it carefully ap-

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law unless "some federal interest requires a different result." (Pet. 8). The decision whether to apply state law under the Bankruptcy Code, like under other federal statutes, is thus a matter of federal choice. *See Burks*, 441 U.S. at 476.

[4] One of the cases on which the Creditor Committee relies began its choice of law analysis with a virtually identical threshold observation. *See Columbia Gas Trans. Corp. v. Exclusive Natural Gas Storage Easement*, 962 F.2d 1192, 1195 (6th Cir.) ("As an initial matter, we have no hesitation concluding, consistent with the threshold *Kimbell Foods* inquiry, that defining the contours of § 717F(h) [of the NGA] is an issue of federal law"), *cert. denied*, 113 S. Ct. 659 (1992). The Sixth Circuit then proceeded to apply the *Kimbell Foods* factors to determine whether federal common law or state law should be adopted as the federal rule of decision. *Id.* at 1195-96. It is unclear how the Creditor Committee could possibly distinguish the approach of the Sixth Circuit, which it approves, from that of the Third Circuit, which it disapproves.

plied the *Kimbell Foods* test, and that it went no farther than necessary to decide the narrow question whether the FERC-ordered refunds should be treated as estate property. The petitioner may be understandably disappointed in the result of the Third Circuit's weighing of the federal interests involved in this case, but it simply has no basis to attack the Third Circuit's approach to the choice of law issue.

## II. THERE IS NO CONFLICT AMONG THE CIRCUITS.

Contrary to the petition's assertion, the decision below does not conflict with *In re Iowa R.R.*, 840 F.2d 535 (7th Cir.), *cert. denied*, 488 U.S. 899 (1988). There the court of appeals, in a case involving interline railroad accounts, followed the same prescribed approach as the Third Circuit did in the case at bar. It noted that property rights under the Code are generally defined by state law but that, in some cases, and especially in cases of pervasive federal regulation, state law might be displaced by federal common law based on federal interests sufficiently strong to demand its creation. 840 F.2d at 537.[5] And although the Seventh Circuit, upon weighing the federal interests involved in that case, concluded that federal common law should *not* be created, a conflict cannot plausibly be set up between that case and the decision below since (a) both cases followed the same analysis and simply reached different conclusions based on the different factual circumstances confronting them, and (b) there is every reason to believe that, faced with the facts

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[5] Compare the Third Circuit's articulation of the governing test ("Federal law should coincide with the relevant state law unless state law would undermine the objectives of the federal statutory scheme and there is a distinct need for nationwide legal standards.") (Pet. App. 48a), with the Seventh Circuit's ("[O]nly a demonstration of a substantial conflict between state law and the achievement of an objective defined by federal law would support a conclusion that federal law controls.") (840 F.2d at 540).

of this case, the Seventh Circuit would reach the same result as the court below.[6]

Nor is it true that " '*Iowa R.R.* is a complete rejection of' " the Third Circuit's earlier decision in *In re Penn Central Transportation Co.*, 486 F.2d 519, 531-533 (3rd Cir. 1973) (*en banc*), *cert. denied*, 415 U.S. 990 (1974). (Pet. 13, quoting *Missouri Pac. R.R. Co. v. Escanaba & Lake Superior R.R.*, 897 F.2d 210, 213 (6th Cir. 1990)). It is true that *Penn Central* ruled that certain interline railroad accounts should be treated as trust funds and that *Iowa R.R.* found that other interline railroad accounts should be treated as property of the estate. But both courts followed the same analytical approach and, moreover, even their specific holdings were not in conflict: the *Iowa* court expressly noted that, had the Iowa railroad used the AAR on-line accounting system rather than the bill-and-voucher system, it might have decided the case in the same way as did the Third Circuit.[7]

In sum, the decision below does not conflict with *In re Iowa* or any other case. The supposedly conflict-creating decisions mentioned in the petition were concerned with certain narrow issues involving the interline railroad industry. By contrast, the Third Circuit here addressed entirely distinct issues involving a different industry and a different federal regulatory scheme. For example, while

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[6] That is because, to use the words of *Iowa R.R.*, in this case there *is* "a concrete federal interest with which the application of state law would interfere" (840 F.2d at 540)—the NGA's central goal of fair and reasonable rates—and there *is* a "substantial conflict between state law and the achievement of an objective defined by federal law" (*id.*).

[7] The most that can be said about the *Iowa* case is that, upon weighing the federal interests involved, it drew different conclusions from the factual circumstances surrounding interline railroad accounts than Judge Adams did, concurring in *Penn Central*. In denying certiorari in the *Iowa* case this Court has already concluded that that conflict was not worthy of review.

the interline railroad cases involved private, voluntary arrangements among the railroads, the case at bar involves interests (the FERC-ordered refunds) which were created by federal law, which are accounted for in elaborate detail pursuant to federal regulation, and which federal law requires to be flowed through to customers pursuant to a comprehensive federal scheme regulating the natural gas industry. In determining that federal common law should apply here, the court of appeals expressly found a *greater* federal interest in this case than exists in the interline railroad cases. (Pet. App. 51a-52a). Thus, this case creates no conflict needing resolution by this Court.

## III. THE RESULT BELOW WAS CORRECT.

We suggested above that petitioner's true complaint is with the result of the Third Circuit's application of the *Kimbell Foods* factors, rather than with that court's analytical approach, which is beyond rebuke if its opinion is fairly read. Although the court's application of the settled *Kimbell Foods* test to the particular facts of this case would not warrant review here in any event, the Third Circuit's correct application is further reason for denying certiorari.

The *Kimbell Foods* test asks first whether a uniform federal rule is warranted. On that score the Third Circuit rightly pointed out:

> The refunds at issue are created by an order of FERC. Their purpose is to compensate customers who have been charged excessive rates for natural gas. Private parties may not alter the refund orders by contract or otherwise. Indeed, the very purpose of the NGA is to supersede private contractual arrangements that interfere with the federal objective of ensuring that pipelines charge only reasonable rates. Because the refunds arise directly from federal law and implement the central objective of the NGA,

> the property rights Columbia has in these customer refunds should not be subject to the vagaries of state trust law.

(Pet. App. 48a-49a). The court then addressed the second test, correctly ruling that "applying state law to determine Columbia's property rights in the refunds would frustrate the NGA's central purpose, to provide natural gas to the public at reasonable rates." (*Id.* at 49a). Finally, the Third Circuit recognized that the third test was satisfied as well, since "applying federal law will not upset commercial expectations that state law would govern." (*Id.* at 50a).

Recognizing that the state law rule it champions would interfere with FERC's order and the NGA goal of getting the refunds into the hands of the gas consuming public, the petitioner does not seriously challenge the court of appeals' resolution of the first two *Kimbell Foods* tests.[8] Instead petitioner focuses on the third consideration and contends that the decision below has upset commercial expectations and will frustrate and confuse creditors of federally regulated entities. (Pet. 17-18). That contention is unrealistic. No creditor predicated its financial dealings with Columbia on the hope, let alone a legitimate expectation, that in the event of Columbia's bankruptcy its claims could be satisfied out of FERC-ordered refunds which coincidentally happened to be passing through Columbia as a conduit on the way to the gas consuming public. It is equally unlikely that creditors of other federal regulated entities will be disabled from making sound credit decisions—leading to "a drastic and negative effect on the credit market for (those) entities" (Pet. 18)—unless they can be certain that funds temporarily held by those entities for the benefit of others, under order of a

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[8] The petitioner's complaint that the Third Circuit's approach was "result-oriented" (Pet. 7, 14) is unwarranted: *Kimbell Foods* itself is result-oriented to the extent that it requires that federal law apply if state law would frustrate specific federal objectives.

federal regulatory agency, will be counted as the entity's available assets in the event of bankruptcy.

Finally, this Court has twice noted the importance of "prevent[ing] a party from receiving 'a windfall merely by reason of the happenstance of bankruptcy.' " *Butner*, 440 U.S. at 55, quoting *Lewis v. Manufacturers National Bank of Detroit*, 364 U.S. 603, 609 (1961). Yet the petitioner's view if adopted would allow the creditors to receive a windfall simply because of the happenstance of Columbia's bankruptcy when the refunds were passing through its hands. The Third Circuit correctly avoided that result.[9]

In short, the decision below adhered closely to this Court's precedents, creates no conflict with the decision of any other circuit, and was decided correctly.[10]

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[9] The Third Circuit's result is further supported by the legislative history of § 541(d), which evidences Congress' intent "that when a debtor is a mere conduit for funds to travel from one party to another, it lacks an equitable interest in the monies." (Pet. App. 57a). *Accord, T&B Scottsdale Contractors, Inc. v. United States*, 866 F.2d 1372, 1376 (11th Cir.), *cert. denied*, 493 U.S. 846 (1989).

[10] We are authorized to state that Columbia and its parent corporation, Columbia Gas System, Inc., join in this brief and the positions stated herein. Columbia is the wholly-owned subsidiary of Columbia Gas System, Inc., which is a publicly traded company. Neither Columbia nor Columbia Gas System, Inc. has any subsidiaries that are not wholly owned, except that Columbia Gas System, Inc. owns 90.8% of Columbia LNG Corporation. The remainder of Columbia LNG Corporation is owned by Shell LNG Company.

## CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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